

Report  
of the  
Millers Classified Insurance Company  
Madison, Wisconsin  
As of December 31, 2002

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

*Jim Doyle, Governor*  
*Jorge Gomez, Commissioner*

*Wisconsin.gov*

October 30, 2003

125 South Webster Street • P.O. Box 7873  
Madison, Wisconsin 53707-7873  
Phone: (608) 266-3585 • Fax: (608) 266-9935  
E-Mail: [information@oci.state.wi.us](mailto:information@oci.state.wi.us)  
Web Address: [oci.wi.gov](http://oci.wi.gov)

Honorable Alfred W. Gross  
Chairman, Financial Condition (E)  
Committee, NAIC  
Commissioner of Insurance  
Commonwealth of Virginia  
Tyler Building  
Post Office Box 1157  
Richmond, Virginia 23218

Honorable Sally McCarty  
Secretary, Midwestern Zone, NAIC  
Commissioner of Insurance  
State of Indiana  
311 West Washington St., Suite 300  
Indianapolis, Indiana 46204-2787

Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioners:

In accordance with your instructions, a compliance examination has been made of  
the affairs and financial condition of:

MILLERS CLASSIFIED INSURANCE COMPANY  
Madison, Wisconsin

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of the company was conducted in 1998 as of  
December 31, 1997. The current examination covered the intervening period ending  
December 31, 2002, and included a review of such 2003 transactions as deemed necessary to  
complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

**Independent Actuary's Review**

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance (OCI). They reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

## II. HISTORY AND PLAN OF OPERATION

The company was organized in 1985, as Classified Insurance Company of Wisconsin, as part of the Classified Financial Corporation holding company system. The company was licensed and commenced business on January 1, 1986, when it assumed the direct personal lines of business of American Star Insurance Company, which was at that time an affiliate. In February 1988, the company changed its name to Classified Insurance Company, Inc.

The company was purchased from Classified Financial Corporation by Millers Mutual Insurance Association of Illinois (Millers Mutual), a mutual property and casualty insurer domiciled in the state of Illinois, in 1990. Millers Mutual was also the ultimate parent of Millers General Insurance Company.

On January 1, 1995, the company merged with Millers General Insurance Company (Millers General) with Millers General being the surviving company. Prior to the merger, on November 1, 1994, Millers General redomesticated from Illinois to Wisconsin. After the merger, Millers General changed its name to that currently used.

In 2002, the company wrote direct premium in the following states, as reported in the annual statement:

Wisconsin	\$ 5,562,455	34%
Missouri	5,286,712	33
Illinois	4,579,314	28
Iowa	657,686	4
Ohio	<u>143,928</u>	<u>1</u>
	<u>\$16,230,095</u>	<u>100%</u>

In addition to these states, the company is also licensed in Colorado, Kansas, North Dakota, and South Dakota.

The major products marketed by the company include homeowners multiple peril, private passenger auto liability, and auto physical damage. The major products are marketed mainly through direct response methods, and also via the company's affiliated agency, D.R. Sparks Insurance Services, Inc. Personal service representatives employed by the company service all new and existing business.

The following table is a summary of the net insurance premiums written by the company in 2002. The growth of the company is discussed in the Financial Data section of this report.

<b>Line of Business</b>	<b>Direct Premium</b>	<b>Reinsurance Assumed</b>	<b>Reinsurance Ceded</b>	<b>Net Premium</b>
Fire	\$ 20,065	\$3,133	\$ 2,431	\$ 20,767
Allied lines	8,632	1,310	767	9,175
Homeowners multiple peril	3,207,940		450,969	2,756,971
Inland marine	167,207		13,843	153,364
Earthquake	113,039		25,812	87,227
Other liability - occurrence	64,550		61,376	3,174
Private passenger auto liability	6,382,138		300,434	6,081,704
Auto physical damage	<u>6,266,525</u>	<u>          </u>	<u>100,094</u>	<u>6,166,431</u>
Total All Lines	<u>\$16,230,096</u>	<u>\$4,443</u>	<u>\$955,726</u>	<u>\$15,278,813</u>

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of six members. All directors are elected annually to serve a one-year term. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive no compensation for serving on the board; however, directors' fees are allocated to Millers Classified through a service agreement with Millers First Insurance Company, its parent.

Currently, the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Steven L. Berg Chesterfield, Missouri	Vice President and Treasurer, Millers First Insurance Company	2004
William C. Bouchein St. Louis, Missouri	Vice President, Cass Information Systems, Inc.	2004
Thomas W. Hurd Pittsfield, Illinois	Vice President, United Feeds Inc.	2004
James T. Little University City, Missouri	Professor, Washington University	2004
Robert L. Mawhorter Godfrey, Illinois	Retired Sr Vice President and Secretary, Millers First Insurance Company	2004
George S. Milnor Alton, Illinois	President and CEO, Millers First Insurance Company	2004



## Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2002 Compensation
George S. Milnor	President and CEO	\$180,562*
John F. Robinson	Vice President, Claims	102,194*
Steven L. Berg	Vice President, Secretary and Treasurer	98,798*
Cynthia L. Ellis	Assistant Secretary	41,550*

\*Compensation reported is total compensation paid by the company's parent, Millers First Insurance Company. Millers Classified is allocated a portion of compensation paid under an operating agreement with Millers First.

## Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

### Executive Committee

Thomas W. Hurd  
George S. Milnor  
Steven L. Berg

### Audit Committee\*

James T. Little  
Thomas W. Hurd  
Robert W. Schrimpf

### Compensation Committee\*

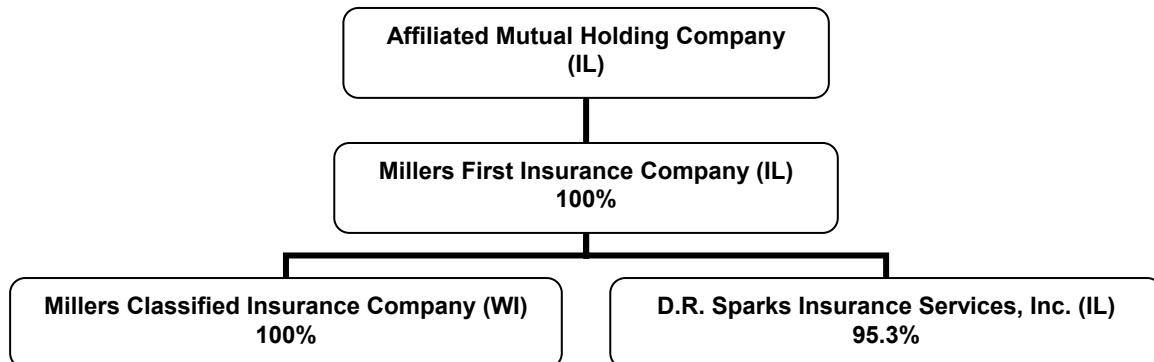
William C. Bouchein  
Thomas W. Hurd  
Edward P. Milbank

\*These committees are appointed by the Board of Directors of the company's parent, Millers First Insurance Company. Committee members are outside directors of Millers First, and the committees act on behalf of both Millers First and Millers Classified.

#### IV. AFFILIATED COMPANIES

Millers Classified Insurance Company (MCIC) is a member of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of MCIC follows the organizational chart.

**Organizational Chart  
As of April 2, 2003**



On July 30, 2002, the Board of Directors of Millers Mutual Insurance Association adopted a plan of conversion whereby Millers Mutual proposed to convert to a stock company under a mutual holding company structure. The plan was approved at a special meeting of policyholders on February 28, 2003, and was approved by the Illinois Insurance Department with an effective date of April 2, 2003.

Under the plan, Affiliated Mutual Holding Company (AMHC) was organized on April 1, 2003. On April 2, 2003, Millers Mutual was reorganized and became an Illinois stock insurance company with the name Millers First Insurance Company. 100% of the outstanding shares of voting stock of Millers First was issued to and is owned by AMHC. Millers Classified Insurance Company remained a wholly owned subsidiary of Millers First and was not impacted by the reorganization. Wisconsin approved the change of control of Millers Classified to AMHC on April 2, 2003.

##### **Millers First Insurance Company (MFIC)**

MFIC is a stock property and casualty insurer operating under the laws of the state of Illinois. The company writes primarily private passenger auto liability, auto physical damage, and

homeowners multiple peril, and operates in the Midwest. Prior to 2000, MFIC wrote commercial agribusiness; the company exited this market in the fourth quarter of 2000 due to high underwriting losses. MFIC continues to pay agribusiness claims as this business is in runoff. As of December 31, 2002, the company's audited financial statement reported assets of \$54,763,135, liabilities of \$36,382,259, and policyholders' surplus of \$18,380,876. Operations for 2002 produced a net loss of \$(460,126).

**D.R. Sparks Insurance Services, Inc. (DR Sparks)**

D.R. Sparks serves as an insurance broker for business placed in Missouri and Illinois, including business placed with MFIC and MCIC. As of December 31, 2002, the company's unaudited financial statement reported assets of \$2,877,552, liabilities of \$2,647,732, and net worth of \$229,820. Operations for 2002 produced a net loss of \$(76,466).

**Affiliated Service Agreement**

Millers First Insurance Company, as parent, provides various management, administrative, and operational services to Millers Classified Insurance Company's business, in accordance with an agreement effective July 1, 1994.

Management services include, but are not limited to, appointment of agents, establishment of underwriting guidelines, reinsurance placement, securing of professional liability and other corporate insurance protection, state filing compliance, monitoring of legislative and judicial developments, corporate planning, administration of payroll and employees' benefits, and other general executive management responsibilities.

Administrative and operational services are provided as needed in connection with human resources, pricing and product development, marketing, sales, underwriting, claims examining and adjustment, claims litigation, financial accounting, data processing, and investment activities. MFIC completely directs and controls all employees performing services for the benefit of the company. All employees performing services under the agreement are employees of MFIC.

Fees under the agreement consist of both a corporate and service fee. The corporate fee is computed at \$600 per million of net premium earned. The service fee is

computed based upon direct allocation of expenses directly attributable to the company, upon allocations proportional to premiums or salaries, or upon special studies. One-twelfth of the annual corporate fee is to be paid to Millers First per month. Every month the company's parent calculates the service fee and bills the company appropriately. Remuneration of the billed service fees is transacted within the month following the billing. Termination of the agreement may be initiated with 30 days' prior written notice by either party on any December 31.

#### **Tax Allocation Agreement**

Millers Classified's federal income tax return is consolidated with that of Millers First and its other subsidiary, D.R. Sparks Insurance Services, Inc. The consolidated tax liability is apportioned among the members of the Millers First group by the ratio of that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income. Each member pays to the other members, with excess losses or tax credits, its allocable share of the amounts allocated pursuant to the above, no later than 30 days after the filing of the consolidated return. The agreement applies to all taxable years during which the company is a member of the affiliated group, unless earlier terminated by signed written agreement.

## V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. All contracts include both MCIC and MFIC as reinsured parties. The contracts contained proper insolvency provisions.

### Nonaffiliated Ceding Contracts

1. Type: Property Catastrophe Excess of Loss

Reinsurers: American Agricultural Ins Co; Continental Casualty Co; Employers Mutual Casualty Co; Farm Family Casualty Ins Co; GE Reinsurance Corp; Lansforsakringar Wasa Forsakringsaktiebolag; Odyssey America Reinsurance Corp; SPS Reassurance S.A.; Mapfre Reinsurance Corp; St. Paul Fire and Marine Insurance Co; XL Re Ltd; Various Lloyd's syndicates

Scope: All property business

Coverage:

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>
Retention	\$1,500,000	\$5,000,000	\$10,000,000
Limit*	3,500,000	5,000,000	10,000,000
Aggregate Limit	7,000,000	10,000,000	20,000,000

\*Company retains 5% of covered losses in addition to base retention.

Premium: Gross Net Written Premium times a factor, subject to a minimum. Deposit premiums are required and must be paid in semi-annual installments on January 1 and July 1

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>
Premium Factor	8.3316%	5.2899%	6.14%
Minimum	\$425,250	\$270,000	\$280,000
Deposit Premium	\$472,500	\$300,000	\$350,000

Commissions: None

Effective date: January 1, 2002

Termination: January 1, 2003

2. Type: Property Per Risk Excess of Loss

Reinsurers: GE Reinsurance Corp; St. Paul Fire and Marine Insurance Co; Employers Mutual Casualty Co

Scope: All property business written as general business or agribusiness

Coverage:	<u>First Excess*</u>	<u>Second Excess*</u>	<u>General Business*</u>
Retention	\$500,000	\$2,500,000	\$250,000
Limit	2,000,000	2,500,000	1,500,000
Aggregate Limit	4,000,000	5,000,000	3,000,000

\*First and second excess layers cover agribusiness.

Premium: Gross Net Earned Premium times a factor, subject to a minimum. Deposit premiums are required and must be paid in quarterly installments on January 1, March 1, July 1, and October 1.

	<u>First Excess</u>	<u>Second Excess</u>	<u>General Business</u>
Premium Factor	35.00%	15.00%	2.65%
Minimum	\$50,000	\$20,000	\$133,280
Deposit Premium	\$50,000	\$20,000	\$166,600

Commissions: None

Effective date: July 1, 2002

Termination: July 1, 2003

3. Type: Personal Umbrella Quota Share Reinsurance Contract
 

Reinsurer: Employers Mutual Casualty Company; GE Reinsurance Corp; St. Paul Fire and Marine Insurance Co

Scope: All personal umbrella business

Coverage: 95% quota share, subject to a maximum liability of \$1,900,000. Company retains a 5% quota share.

Premium: 95% of original premiums received

Commissions: 24.75% on all premiums

Effective date: July 1, 2002

Termination: July 1, 2003; or the company may terminate the contract at the end of any calendar quarter by providing 30 days prior written notice.
4. Type: First Casualty Excess of Loss
 

Reinsurers: Employers Mutual Casualty Company; GE Reinsurance Corp; St. Paul Fire and Marine Ins Co

Scope: All casualty business

Coverage:
 

	<u>Section A*</u>	<u>Section B*</u>
Retention	\$250,000	\$150,000
Limit	750,000	850,000
Aggregate Limit	None	850,000

\*Section A applies to agribusiness and bond business; Section B applies to all other business.

Premium: Gross Net Earned Premium times a factor, subject to a minimum. Deposit premiums are required and must be paid in quarterly installments on July 1, October 1, January 1, and April 1.

	<u>Section A</u>	<u>Section B</u>
Premium Factor	30.00%	3.75%
Minimum	\$75,000	\$310,000
Deposit Premium	\$75,000	\$380,000

Commissions: None

Effective date: July 1, 2002

Termination: July 1, 2003; or the company may terminate the contract at the end of any calendar quarter by providing 30 days prior written notice

5. Type: Second Casualty Excess of Loss

Reinsurers: Employers Mutual Casualty Co; GE Reinsurance Corp; St. Paul Fire and Marine Insurance Co

Scope: All casualty business

Coverage:

	<u>Bond Business</u>	<u>Other Business</u>
Retention	\$1,000,000	\$1,000,000
Limit	500,000	4,000,000
Aggregate Limit	None	4,000,000

Premium: 20% of Gross Net Earned Premium, subject to a minimum of \$200,000. Deposit premiums of \$210,000 are required and must be paid in quarterly installments on July 1, October 1, January 1, and April 1.

Commissions: None

Effective date: July 1, 2002

Termination: July 1, 2003; or the company may terminate the contract at the end of any calendar quarter by providing 30 days prior written notice.

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported in the December 31, 2002, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination is noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."



**Millers Classified Insurance Company**  
**Assets**  
**As of December 31, 2002**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$18,413,321		\$18,413,321
Cash	1,361,177		1,361,177
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	191,456	\$ 8,379	183,077
Premiums, agents' balances, and installments booked but deferred and not yet due	639,421		639,421
Reinsurance recoverable on loss and loss adjustment expense payments	21,667		21,667
Federal and foreign income tax recoverable and interest thereon	2,709,954	2,709,954	0
Guaranty funds receivable or on deposit	38,790		38,790
Interest, dividends, and real estate income due and accrued	229,084		229,084
Receivable from parent, subsidiaries, and affiliates	<u>863,178</u>	<u>                    </u>	<u>863,178</u>
Total Assets	<u>\$24,468,048</u>	<u>\$2,718,333</u>	<u>\$21,749,715</u>

**Millers Classified Insurance Company**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2002**

Losses	\$ 5,406,137	
Reinsurance payable on paid loss and loss adjustment expenses	70,477	
Loss adjustment expenses	1,347,296	
Commissions payable, contingent commissions, and other similar charges	78,121	
Other expenses (excluding taxes, licenses, and fees)	108,668	
Taxes, licenses, and fees (excluding federal and foreign income taxes)	55,549	
Unearned premiums	4,820,353	
Advance premium	372,323	
Ceded reinsurance premiums payable (net of ceding commissions)	(2,702)	
Amounts withheld or retained by company for account of others	30,353	
Drafts outstanding	775,084	
Payable to parent, subsidiaries, and affiliates	<u>562,698</u>	
 Total Liabilities		 \$13,624,357
 Common capital stock	 4,000,000	
Gross paid in and contributed surplus	14,176,598	
Unassigned funds (surplus)	<u>(10,051,240)</u>	
 Surplus as Regards Policyholders		 <u>8,125,358</u>
 Total Liabilities and Surplus		 <u>\$21,749,715</u>

**Millers Classified Insurance Company  
Summary of Operations  
For the Year 2002**

**Underwriting Income**

Premiums earned		\$14,980,343
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Deductions:

Losses incurred	\$10,504,798	
Loss expenses incurred	2,054,097	
Other underwriting expenses incurred	<u>4,151,247</u>	
Total underwriting deductions		<u>16,710,142</u>

Net underwriting gain or (loss)		(1,729,799)
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**Investment Income**

Net investment income earned	881,426	
Net realized capital gains or (losses)	<u>73,101</u>	
Net investment gain or (loss)		954,527

**Other Income**

Net gain or (loss) from agents' or premium balances charged off	(33,862)	
Finance and service charges not included in premiums	103,623	
Write-ins for miscellaneous income:		
Other Income	<u>16,611</u>	
Total other income		<u>86,372</u>

Net Loss		<u>\$ (688,900)</u>
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**Millers Classified Insurance Company**  
**Cash Flow**  
**As of December 31, 2002**

Premiums collected net of reinsurance	\$15,114,820	
Deduct:		
Loss and loss adjustment expenses paid (net of salvage or subrogation)	12,879,553	
Underwriting expenses paid	4,136,117	
Other underwriting income (expenses)	<u>(8,241)</u>	
Cash from underwriting		\$(1,909,091)
Net investment income		964,228
Other income (expenses):		
Agents' balances charged off	(33,862)	
Net amount withheld or retained for account of others	(617)	
Write-ins for miscellaneous items:		
Finance and Service Charges	103,623	
Other Income	<u>16,614</u>	
Total other income		<u>85,758</u>
Net cash from operations		\$(859,105)
Proceeds from investments sold, matured, or repaid:		
Bonds	<u>9,759,195</u>	
Total investment proceeds		9,759,195
Cost of investments acquired (long-term only):		
Bonds	<u>10,039,533</u>	
Total investments acquired		<u>10,039,533</u>
Net cash from investments		(280,338)
Cash provided from financing and miscellaneous sources:		
Total		0
Cash applied for financing and miscellaneous uses:		
Net transfers to affiliates	508,375	
Other applications	<u>17,528</u>	
Total		<u>525,903</u>
Net cash from financing and miscellaneous sources		<u>(525,903)</u>
Net change in cash and short-term investments		(1,665,346)
<b>Reconciliation</b>		
Cash and short-term investments, December 31, 2001		<u>3,026,522</u>
Cash and short-term investments, December 31, 2002		<u>\$1,361,176</u>

**Millers Classified Insurance Company  
Compulsory and Security Surplus Calculation  
December 31, 2002**

Assets	\$21,749,715	
Less security surplus of insurance subsidiaries	0	
Less liabilities	<u>13,624,357</u>	
Adjusted surplus		\$8,125,358
Annual premium:		
Lines other than accident and health	15,278,813	
Factor	<u>20%</u>	
Compulsory surplus (subject to a minimum of \$2 million)		<u>3,055,763</u>
Compulsory surplus excess (or deficit)		<u>\$5,069,595</u>
Adjusted surplus (from above)		\$8,125,358
Security surplus:		
(140% of compulsory surplus, factor reduced 1% for each		
\$33 million in premium written in excess of		
\$10 million, with a minimum factor of 110%)	<u>4,278,068</u>	
Security surplus excess (or deficit)		<u>\$3,847,290</u>

**Millers Classified Insurance Company**  
**Reconciliation and Analysis of Surplus**  
**For the Five-Year Period Ending December 31, 2002**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>
Surplus, beginning of year	\$8,741,109	\$8,704,314	\$11,243,527	\$9,522,766	\$7,984,740
Net income	(688,900)	14,373	(2,448,163)	1,723,778	1,536,135
Net unrealized capital gains or (losses)	0	90,938	(90,938)	0	0
Change in net deferred income tax	2,139,460	(47,380)	0	0	0
Change in non-admitted assets	(2,132,028)	(577,795)	3,834	(3,251)	(2,077)
Change in provision for reinsurance	65,717	(62,711)	(3,006)	185	3,341
Cumulative effect of changes in accounting principles	0	619,370	0	0	0
Write-ins for gains and (losses) in surplus:					
Change in excess of statutory reserves over statement reserves	0	0	(940)	49	627
Surplus, end of year	<u>\$8,125,358</u>	<u>\$8,741,109</u>	<u>\$8,704,314</u>	<u>\$11,243,527</u>	<u>\$9,522,766</u>

**Millers Classified Insurance Company**  
**Insurance Regulatory Information System**  
**For the Five-Year Period Ending December 31, 2002**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

<b>Ratio</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>
#1 Gross Premium to Surplus	200%	172%	158%	124%	158%
#2 Net Premium to Surplus	188	156	143	111	142
#3 Change in Net Writings	12	9	-1	-7	-10
#4 Surplus Aid to Surplus	0	0	0	0	0
#5 Two-Year Overall Operating Ratio	102*	109*	103*	89	96
#6 Investment Yield	4.4*	5.2	5.8	5.9	5.9
#7 Change in Surplus	-6	-4	-17*	15	16
#8 Liabilities to Liquid Assets	65	63	64	56	63
#9 Agents' Balances to Surplus	2	2	1	0	2
#10 One-Year Reserve Devel. to Surplus	0	-12	-9	-11	-26
#11 Two-Year Reserve Devel. to Surplus	-16	-12	-18	-29	-16
#12 Estimated Current Reserve Def. To Surplus	16	7	-13	0	-21

Ratio 5 is a measure of the profitability of an insurance company. The company's exceptional results in 2000, 2001, and 2002 are due to underwriting losses as a result of high incurred losses. Losses in 2001 were impacted by a catastrophic windstorm; no one loss event impacted losses in 2000 or 2002. A high expense ratio in 2000 also contributed to the operating loss.

Ratio 6 provides an indication of the general quality of a company's investment portfolio. The exceptional result of 4.4% in 2002 was just below the normal range of 4.5%, and can be attributed to the low interest rates available in the market during that year.

Ratio 7 measures improvement or deterioration in the company's financial condition during the year. The large decline in surplus in 2000 was a result of the operating loss in that year.

#### **Growth of Millers Classified Insurance Company**

<b>Year</b>	<b>Admitted Assets</b>	<b>Liabilities</b>	<b>Surplus As Regards Policyholders</b>	<b>Net Income</b>
2002	\$21,749,715	\$13,624,357	\$8,125,358	\$(688,900)
2001	22,579,993	13,838,884	8,741,109	14,373
2000	23,178,025	14,473,711	8,704,314	(2,448,163)
1999	24,941,323	13,697,796	11,243,527	1,723,778
1998	25,180,970	15,658,204	9,522,766	1,536,135
1997	26,323,927	18,339,187	7,984,740	361,720

<b>Year</b>	<b>Gross Premium Written</b>	<b>Net Premium Written</b>	<b>Premium Earned</b>	<b>Loss And LAE Ratio</b>	<b>Expense Ratio</b>	<b>Combined Ratio</b>
2002	\$16,234,539	\$15,278,813	\$14,980,343	83.8%	26.6%	110.4%
2001	15,056,582	13,633,428	13,266,540	79.8	27.4	107.2
2000	13,762,065	12,471,339	12,261,961	89.4	40.5	129.9
1999	13,968,913	12,533,775	12,883,118	65.5	32.9	98.4
1998	15,034,802	13,528,517	13,782,885	68.2	31.7	99.9
1997	16,825,756	14,955,606	16,968,432	80.5	29.8	110.3

MCIC suffered underwriting losses in 2000, 2001, and 2002, which have reduced surplus almost to 1997 levels. Much of the loss in 2001 was due to a catastrophic windstorm; no one loss event was responsible for the high losses in 2000 and 2002. Expenses also increased from 1997 to 2000 due to various restructuring actions by the company, before beginning to

decline in 2001; the increased expenses impacted the company's underwriting profitability. Expenses were also high due to the amortization of EDP equipment and software; MFIC replaced its primary operating and financial reporting systems in the mid to late 1990s, and MCIC participated in the amortization of these costs.

In the years from 1997 to 1999, MCIC was in the midst of a strategic restructuring. The company withdrew entirely from several unprofitable states and withdrew from unprofitable lines in others; made an effort to downsize windstorm and earthquake exposures; and made other changes designed to improve and stabilize operations. The company's gross and net premiums written have increased since 2000 mainly because of rate increases, but also due to managed, controlled growth. In 2001 and 2002, MCIC chose to focus on rate strengthening and business quality improvement, rather than premium growth.



**Reconciliation of Surplus per Examination**

There were no reclassifications or adjustments to surplus as a result of the examination.

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were eight specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Conflict of Interest Questionnaire— It is recommended that company officers and board members fully complete a related party questionnaire annually in accordance with a directive issued by the Commissioner of Insurance.

Action—Compliance.

2. Safekeeping Agreement — It is recommended that the company amend its custodial agreements to include an indemnification clause for any loss securities of the company held by the custodian caused by negligence, dishonesty of the bank, or trust company in accordance with the NAIC Examiners Handbook. Furthermore, the agreement should state that in the event of a loss of securities for which the bank or trust company is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

Action—Compliance.

3. Nonaffiliated Ceding Reinsurance Agreements — It is recommended that the company amend or reissue the non-affiliated ceding reinsurance agreements, placed through a reinsurance intermediary, to use the correct legal names of the ceding companies.

Action—Compliance.

4. Payable to Affiliate — It is recommended that the company properly accrue expenses from January 1 through December 31 for each calendar year pursuant to the instructions of the NAIC Annual Statement Instructions-Property and Casualty.

Action—Compliance.

5. Information Systems — It is recommended that the company revise and update its Disaster Recover Plan to reflect the major changes in the Information Systems environment.

Action—Compliance.

6. Information Systems — It is further recommended that the company develop a Business Continuation Plan to address the recovery of all necessary business operations.

Action—Compliance.

7. Loss Reserves — It is suggested that the company include in its reconciliation of Schedule P to its actuarial database all data for special property and ceded data for homeowners business.

Action—Compliance.

8. Loss Reserves — It is suggested that the company direct its outside actuary to utilize additional reasonability checks and provide additional comments regarding such in future reports.

Action—Compliance.

## **Summary of Current Examination Results**

### **Affiliated Service Agreement**

During review of the service agreement, it was noted that the agreement is still executed between Millers Mutual Insurance Association and Classified Insurance Company. The agreement has not been updated to reflect the mergers, reorganizations, and name changes that have taken place since the agreement was originally executed in 1994, nor is the company currently in the process of updating the agreement. This creates a potential for legal complications should a dispute arise under the agreement. It is recommended that the company update the Affiliated Service Agreement to reflect the current legal names of both parties to the agreement.

### **Disaster Recovery Plan**

The prior examination report contained a recommendation that the company revise and update its Disaster Recovery Plan to reflect the major changes in the Information Systems environment. The company did revise and update its Disaster Recovery Plan after the prior examination. However, since that examination the company has undergone significant reduction in staff and changes in job functions, and the Disaster Recovery Plan again needs to be updated to reflect the changes that have taken place. It is recommended that the company submit a revised and updated Disaster Recovery Plan to this office by September 30, 2004.

## **VIII. CONCLUSION**

The examination found that Millers Classified Insurance Company had assets of \$21,749,715; liabilities of \$13,624,357; and surplus of \$8,125,358 as of December 31, 2002.

The company has suffered underwriting losses in the past three years, but has continued a strategic restructuring designed to improve and stabilize its business. Steps in this restructuring have included withdrawal from unprofitable lines and states, and reduction of windstorm and earthquake exposures, as well as expense management and cost reduction initiatives. The company continues to explore strategies for improving underwriting performance. The company's loss and loss adjustment expense reserves have historically been adequate to support the business written.

The company complied with all prior examination recommendations. The current examination resulted in two recommendations, with no adjustments or reclassifications as to surplus.

## **IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

1. Page 26 - Affiliated Agreement— It is recommended that the company update the Affiliated Service Agreement to reflect the current legal names of both parties to the agreement. It is recommended that the company update the Affiliated Service Agreement to reflect the current legal names of both parties to the agreement.
2. Page 26 - Disaster Recovery Plan— It is recommended that the company submit a revised and updated Disaster Recovery Plan to this office by September 30, 2004.

## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance (OCI), State of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Sonja M. Dedrick	Insurance Examiner
DuWayne A. Kottwitz	Insurance Examiner
Cruz J. Flores	Data Processing Specialist

Respectfully submitted,

Sarah M. Salmon, CPA  
Examiner-in-Charge